In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1082

BOB HINDES, ET AL, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In 1957, petitioners (husband and wife) entered into a written contract in which they agreed to sell a ranch to Sechrist for $300,000 in cash and Sechrist gave petitioners an earnest money deposit of $5,000. Thereafter, petitioners' attorney informed them that their taxes would be considerably lower if they made the sale on the installment method, receiving less than 30 percent of the purchase price the first year and taking notes for the remainder of the $300,000. Se-

christ, however, insisted on paying the entire purchase price in cash, because he had received $300,000 from an involuntary conversion and had to reinvest the entire amount in order to avoid paying an income tax on the gain realized on the conversion. Pursuant to the advice of petitioners' attorney, the following plan was therefore carried out:

The Tower Farm and Cattle Company, Inc., was chartered under Texas law, with petitioners' parents and attorney as the stockholders. Petitioners sold the ranch to the corporation for an agreed price of $265,000 to be paid in installments over a 10-year period. The corporation then conveyed the ranch to Sechrist for $300,000 cash, using the cash to pay (1) a mortgage on the property, (2) real estate commissions and related selling expenses, (3) a $5,678 income tax on its gain on the sale (*i.e.*, the difference between its "cost" basis of $265,000 and its proceeds of sale of $300,000 less selling expenses), (4) $20,000 to petitioners as the first installment of the corporation's $265,000 debt to them, (5) $200,000 to petitioners as an unsecured five-year loan at four per cent interest, and (6) the remainder of approximately $15,000 as a distribution to the stockholders (who had initially invested $2,000). (Pet. 3, 5-6; R. 6-7).[1]

The district court concluded that the corporation had been used as a conduit in the sale of the ranch from petitioners to Sechrist in an effort to convert a cash sale into an installment sale. 214 F. Supp. 583.

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[1] "R." references are to the record in the court below.

On appeal, the Fifth Circuit agreed, at least to the extent of the $265,000 realized by petitioners in their sale to the corporation. 326 F. 2d 150, certiorari denied, 377 U.S. 908. The court of appeals remanded for consideration of whether the additional $35,000 ($300,000 less $265,000) received by the corporation on the sale to Sechrist was taxable to petitioners. *Ibid.*

On remand the district court concluded that petitioners had sold the property to Sechrist for $300,000, using the corporation as a conduit, and that the $35,000 (less the expenses of sale which petitioners would have incurred had they made the sale directly) was received, in substance, by the petitioners as an integral part of the sale transaction (R. 9). The district court allowed petitioners a credit against their own tax liability for the $5,678 paid by the corporation as federal income tax on the sale of the land, on the condition that the corporation (which was not a party to the litigation) file a refund claim within ten days after the judgment herein becomes final (R. 13-14, 18-19). The corporation had never filed a claim for refund of these taxes and the statute of limitations had already run; moreover, petitioners' refund claim in no way sought to recover the income tax paid by the corporation nor did they allege that a part of the amount which they were seeking to recover had previously been paid by the corporation (Ex. 8, I-R. 62-68).[2]

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[2] "I-R." citations are to the pages of the printed record on appeal in the previous appeal of this case (C.A. 5, No.

The Fifth Circuit affirmed on the petitioners' appeal, thus upholding the district court's conclusion that the petitioners had sold the property to Sechrist. The court reversed on the government's appeal, holding that since no claim for refund had been filed with respect to the tax paid by the corporation, petitioners could not claim credit for it.

In their petition for a writ of certiorari, petitioners argue that they have been taxed on an amount which was actually received by the shareholders of the corporation, and that this exaction (in the guise of an income tax) constitutes an unapportioned direct tax prohibited by Article 1, Section 9, Clause 4, of the Constitution of the United States (Pet. 2, 4). This contention is without merit. Even an erroneous application of the income tax laws does not automatically withdraw an income tax from the sanction of the Sixteenth Amendment. Moreover, the income tax laws were correctly applied in the instant case. Petitioners entered into a written contract to sell the property to Sechrist for $300,000 and accepted a $5,000 deposit. They could not escape the income tax liability thereby created merely by conveying the property to Sechrist through a conduit, a newly-organized corporation owned by their parents and attorney. As this Court concluded with regard to a similar scheme in *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334:

20,604), and "II-R." citations are to the pages of the supplemental printed record in the earlier case. We are lodging herewith a Xerox copy of both these documents.

> A sale by one person [here petitioner] cannot be transformed for tax purposes into a sale by another [here the corporation] by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

See also *Harrison* v. *Schaffner*, 312 U.S. 579; *Griffiths* v. *Commissioner*, 308 U.S. 355.

Petitioners complain that they are being taxed on approximately $15,000 which went to the stockholders of the corporation. However, petitioners had it in their power to receive the full $300,000 sales price and voluntarily chose to convey their rights to the corporation (owned by their parents and attorney) for less than $300,000. It is well established that:

> with reference to taxation, if a man disposes of a fund in such a way that another is allowed to enjoy the income which it is in the power of the first to appropriate it does not matter whether the permission is given by assent or by failure to express dissent. The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not.

Corliss v. *Bowers*, 281 U.S. 376, 378; see also, *Lucas* v. *Earl*, 281 U.S. 111; *Helvering* v. *Horst*, 311 U.S. 112. Since petitioners sold the ranch to Sechrist for $300,000 and then voluntarily agreed to

divert part of the sales proceeds to the corporation, the lower courts correctly held them taxable on the full proceeds of sale.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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